

Asset Class Glossary: Miscellaneous
Policy: Self-Funded Healthcare
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Asset-Backed Security

A security collateralized by assets such as automobile loans, agricultural equipment loans, and credit card loans. The loans are securitized by the issuer and usually placed with a trustee.

Basis Point

~~One one-hundredth of one percent of yield (one basis point = .0001). It is the smallest measure used in quoting yields on bonds and notes.~~

Break-Even Analysis

Uses results from the scenario analysis. Since all projections should be viewed as risky, evaluating the sensitivity of the projected return to adverse market movements is critical. The break-even analysis calculates the movement required to reduce the sector or portfolio returns to a specified level at some horizon. This analysis creates a form of risk/return ratio. The higher the break-even value, the more the cushion against an adverse movement in rates.

Call Risk Analysis

Examines the portfolio's callable securities and estimates the amount of principal returned for a given drop in interest rates.

Cash Equivalents

Includes money market instruments, obligations of the U.S. government and its agencies, commercial paper, bank time deposits, certificates of deposit, banker's acceptances, repurchase agreements, and money market funds as defined under SEC Regulation 270.2a-7.

Convexity

The price change from a move in interest rate that cannot be explained by duration only. Positive convexity (when price rises more than expected and falls less) comes at a cost (lower yield). Negative convexity (price rises less than expected and falls more) usually comes with higher yield.

Credit Rating

A current opinion of an obligor's overall financial capacity (its creditworthiness) to pay its financial obligations. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. In the case of split ratings, the higher rating of either Moody's, Standard & Poor's, or Fitch Investor Services shall apply.

Derivative

An instrument whose value is based on the performance of an underlying financial asset, index, or other investment. Classes of derivatives include futures contracts, options, currency forward contracts, swaps, and options on futures.

Duration

A measure of price sensitivity to interest rate changes. Duration is the anticipated percentage move in price given a 100 basis point (1 percent) move in interest rates.

Economic Analysis

Examines reference points for indications on what to look for and what events are considered significant in the economy to understand relationships among complex and often seemingly unrelated events. This analysis is used in making decisions concerning duration and sector weightings.

Historical Factors

A review of past relationships and the environment associated with them to assess the relative investment potential of the current market conditions and relationships.

Investment Grade

A minimum credit rating of Baa3 by Moody's Investor Service or BBB- for Standard & Poor's Corporation, and BBB- by Fitch. Investment grade ratings apply to issuers whose financial risk is relatively low and the probability of future payment relatively high.

Lehman Brothers U.S. Aggregate Index

This index covers the available market for dollar denominated fixed income securities. It includes all bonds with a remaining maturity of one year or longer with amounts of at least \$250 million outstanding. This includes investment grade corporate, investment grade sovereign, U.S. governments, and mortgage securities. The duration or interest rate sensitivity of this index versus the Lehman Brothers Long Liability Index is significantly less.

Leverage

A condition where a portfolio's market obligation may exceed the market-value-adjusted capital commitment by the amount of borrowed capital (debt).

Mortgage Backed Security (MBS)

A general term used to describe securities backed by mortgages. MBSs are broken down into four types of securities: mortgage pass-through, mortgage-backed bond, collateralized mortgage obligation (CMO), and stripped mortgage-backed bonds. Mortgage pass-throughs are pooled loans, typically issued by the Government National Mortgage Association, Federal National Mortgage Association, and Federal Home Loan Mortgage Corporation. Mortgage-backed bonds have mortgage loans as collateral, but the term and interest payments are fixed. CMOs are defined above. Stripped mortgage-

backed securities have the principal and interest distribution altered from a pro rata distribution to an unequal distribution.

Option

Contracts that give the purchaser the right, but not the obligation, to buy or sell an underlying instrument at a certain price (the exercise or strike price) on or before an agreed date (the exercise period). For this right, the purchaser pays a premium to the seller. The seller (writer) of an option has a duty to buy or sell at the strike price, should the purchaser exercise his right.

Option Adjusted Analysis

A method that strips out embedded options in securities such as callable bonds and mortgage-backed securities, enabling comparisons with other security types within a consistent framework.

Prepayment Variability Analysis

A method that stress tests Collateralized Mortgage Obligations by varying prepayment assumptions to understand and anticipate how the structure changes in a constantly fluctuating interest rate environment.

Scenario Analysis

Projects returns over a number of changing situations (such as interest rates, curve twists, spreads, etc.) and weighs each situation to arrive at an average expected return. This process allows comparisons to varying types of securities and portfolios.

Sovereign

A security issued by a foreign government or government sponsored agency.

Yankee Bonds

Securities issued in the domestic market by foreign borrowers. Yankee bonds must be issued by companies domiciled in G11 countries, Australia, Ireland, or Scotland, and must be rated at least A3 (Moody's) and A- (Standard & Poor's).